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C O N F I D E N T I A L SECTION 01 OF 02 KUALA LUMPUR 000419

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STATE PASS USTR FOR B. WEISEL AND J. JENSEN
USDOC FOR 4430/MAC/EAP D.BISBEE AND J. BAKER

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TAGS: [ETRD](#) [ECON](#) [PREL](#) [PGOV](#) [MY](#)
SUBJECT: SCENESETTER FOR VISIT TO MALAYSIA OF USTR
AMBASSADOR KARAN BHATIA

Classified By: Deputy Chief of Mission David Shear for reasons 1.4 (B and D)

¶1. (C) SUMMARY: Malaysian-American relations are good and improving; the March 8 rollout of the FTA added momentum to the upward trend. This moderate Muslim-majority state is our tenth-largest trading partner worldwide, and is a reliable, if quiet, partner in the fight against terrorism. While moving slowly away from the anti-Western rhetoric of former-Prime Minister Mahathir, Malaysia continues to oppose us on some key international issues. In the economic arena, there still are some who champion the paradigm of north-south conflict, despite the role that economic globalization has played in Malaysia's development. "Bumiputera" preferences for ethnic Malays remain strongly entrenched across wide swaths of the economy. Despite this, the government appears strongly committed to the FTA negotiations. While there are limits to the price they are willing to pay, Malaysian leaders see an FTA as necessary to maintaining the country's economic competitiveness within the Asia-Pacific region. They will be looking to us for innovative compromises that will permit them to pursue their domestic socio-economic goals, while still meeting the requirements of a comprehensive FTA. End Summary.

Political Landscape

¶2. (C) While Malaysia has plenty of warts, it remains a rare example of an Islamic-majority country that is stable, civilian-led and prosperous. Malaysia has also maintained a largely tolerant social system and a tightly managed democracy, with the same multi-racial coalition in power since independence in 1957. While we continue to urge the government of Malaysia to improve its own governance, we also recognize the constructive role Malaysia can play in the Islamic world and have encouraged Malaysians to increase support for moderation and progress in the Middle East.

¶3. (C) Prime Minister Abdullah Badawi is a breath of fresh air after the long-serving and vituperative Mahathir Mohamad, who retired in late 2003. Abdullah promotes a tolerant, progressive approach to religion that he calls "Islam Hadhari" (civilizational Islam). He is publicly committed to fighting corruption and reining in costly mega-projects, though his government's follow-through has been disappointing. His mild-mannered and cautious approach has also led critics to question his leadership and effectiveness, but his ruling coalition remains secure. Abdullah's chief potential rival, Deputy Prime Minister (and Defense Minister) Najib Razak, plays for now the role of a loyal bulwark. After two years in power, Abdullah has appealed to the public for patience in delivering reform. As long as the economy continues to grow healthily, the public

will grant him that.

Economic Situation

14. (C) In his early days, PM Abdullah made rural development and control of government spending, partly as a means to encourage private sector led growth, his top economic priorities. So far, only his reduction of the government's deficit - now down to 3.8 percent of GDP - can be chalked up as a clear success. Abdullah's partisans say that the Ninth Malaysia Plan (NMP; a five year plan for economic policy and development spending) will be the vehicle for advancing his other economic goals, but the NMP will only be unveiled at the end of this month.

15. (C) Meanwhile cuts in government subsidies for gasoline and diesel fuel - one of the steps taken to rein in the deficit - have proved highly unpopular, and raised concerns about inflation. Increases in prices of other government-managed commodities, such as electricity, may be in the works. For now, the economy is in reasonably good shape, with projected growth of around 5.5 percent in 2006 and official inflation of around 3.5 percent (although private analysts believe the real rate of price increases is higher). However, the government may be facing a tough choice in the coming year between stimulating the economy to get back on a higher growth track, or raising interest rates to control inflation.

Malaysia's International Posture

16. (C) Malaysia currently is the chair of the Non-Aligned

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Movement (NAM), the Organization of the Islamic Conference (OIC) and of ASEAN. Malaysia hosted the ASEAN Summit and the East Asia Summit last December, and will host the ASEAN Regional Forum ministerial this summer. Secretary of State Rice has told the ASEAN foreign ministers of her plans to attend the ARF meetings in July. Malaysia backs the six-party DPRK nuclear talks and supports Iraqi reconstruction efforts, but has been overeager to embrace Hamas and defend the Iranian nuclear program. The foreign ministry seems to be moving slowly away from some of Mahathir's anti-Western rhetoric and policies, but retains friendships with troublesome states like Cuba, Zimbabwe, Sudan, Syria and Uzbekistan. The Malaysian government is publicly supportive of China's "peaceful rise" and recently signed a defense cooperation MOU with China, despite lingering suspicions among senior Malaysian military officials of China's long-term intentions. Malaysia has actively supported peace efforts in the southern Philippines and Aceh in Indonesia.

Counterterrorism

17. (C) Malaysia generally has been a reliable and constructive partner on counterterrorism. In 2003, Malaysia established the Southeast Asia Regional Center for Counterterrorism (SEARCCT), which now runs a full schedule of multilateral training courses, many conducted with U.S. support. While the Malaysian leadership firmly opposes terrorist organizations at home, it is deeply uncomfortable with any association of Islam with terrorism, and frequently lectures us on the need to eschew terms such as "Islamic terrorists."

The FTA Negotiations

18. (C) The Malaysian Cabinet gave its approval in December to begin negotiations on an FTA. We have heard that the Finance Ministry was the only agency that opposed the negotiations in

the preliminary discussions, but that the whole Cabinet voted in favor in the end. Subsequent discussions with Malaysian officials suggest that Finance's objections relate to the inclusion of government procurement in the negotiations. We also have encountered concerns at Bank Negara (the central bank, responsible for regulation of the financial sector) about too rapid liberalization of financial services.

¶9. (C) Private sector understanding of the FTA process is shallow. The Malaysian government has not yet evolved the consultative mechanisms that the USG employs to engage our private sector. In the brief period since the rollout, the only private comment has come from AIDS activists concerned about the potential impact on pharmaceutical prices and drug availability. However, there remains a small, but vocal, contingent of officials and public opinion makers who continue to view the world from a 1970's perspective of north-south conflict. The anti-globalization advocates are likely to take aim at the FTA negotiations at some point.

¶10. (C) The strongest opposition is likely to come from those whose individual interests would be adversely impacted by economic reform, most notably ethnic Malays and other indigenous peoples who benefit from bumiputera (translated as "sons of the soil") preferences. Such preferences pervade almost every aspect of the economy - from reserving retail space on the shelves of hypermarkets, to preserving local, in particular Malay, control of domestic banks. They are perceived by the political elite as necessary to maintain racial harmony, or at least to retain control the Malay vote. We also are likely to encounter resistance to addressing some Islamic elements of Malaysia's economic policy, such as halal rules for food products.

¶11. (C) Despite these potential sticking points, the Malaysian government appears to be strongly committed to successfully concluding the FTA. While there are limits to the price they are willing to pay, Malaysian leaders see an FTA as necessary to maintaining the country's economic competitiveness within the Asia-Pacific region. They will be looking to us to suggest compromises that will permit them to pursue their domestic socio-economic goals, while still meeting the requirements of a comprehensive FTA. Or as MITI Minister Rafidah put it, to devise a prenuptial agreement that is sufficiently flexible to allow both parties to proceed to a happy marriage.

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